

DECISION OF MUNICIPAL TAX HEARING OFFICER

Decision Date: October 18, 2010

Decision: MTHO # 587

Taxpayer:

Tax Collector: Town of Queen Creek

Hearing Date: September 23, 2010

DISCUSSION

Introduction

On October 27, 2009, a letter of protest was filed by *Taxpayer* of a tax assessment made by the Town of Queen Creek (“Town”). A hearing was commenced before the Municipal Tax Hearing Officer (“Hearing Officer”) on September 23, 2010. Appearing for the City were *auditor* for the Town and *Town Controller*. Appearing for Taxpayer was *Member of Taxpayer*. At the conclusion of the September 23, 2010 hearing, the record was closed. On September 24, 2010, the Hearing Officer indicated a written decision would be issued on or before November 24, 2010.

DECISION

The Town conducted an audit of Taxpayer for the month of November 2008. The Town concluded Taxpayer had made a speculative builder sale on November 9, 2008 in the amount of \$6,050,000.00 to *New Buyer’s*. Taxpayer had built a drugstore at *Undisclosed Location* for *Quick Trip Store*. Prior to commencing construction on the improvements, Taxpayer had entered into a 75 year lease with *Quick Trip Store* at the rate of \$33,000.00 per month. As part of the sale agreement to the *New Buyers*, Taxpayer had to transfer all rights, title and interest in the *Quick Trip Store* lease.

Town Code Section 8A-416 (“Section 416”) imposes a tax on the gross income from the activity of engaging in business as a speculative builder. Town Code Section 8A-100 (“Section 100”) defines a speculative builder as an owner-builder who sells or contracts to sell improved real property before the expiration of twenty-four months after the improvements to the real property sold are substantially completed. Section 416 imposes the tax on “the total selling price of improved real property”. Since the gross selling price to the *New Buyers* was \$6,050,000.00, the Town calculated the tax on that amount. On September 10, 2009, the Town issued an assessment for taxes due in the amount of \$103,210.82, interest up through September 2009 in the amount of \$3,870.38, and penalties for failure to file reports and failure to timely pay taxes in the amount of

\$25,802.71. Subsequently, the Town determined that Taxpayer had filed a report for rental tax for November 2008 and revised the penalty amount to \$5,160.54.

Taxpayer disputed the Town's use of the entire selling price being attributable to the sale of improved real property. Taxpayer asserted that the sales price consisted of two components: the sale of the improved real property and the sale of the lease agreement. According to Taxpayer, the value of the *Undisclosed Location* without the lease agreement in place would be less than the actual cost of construction. Taxpayer computed the present value of the 75 year lease to be \$3,299,574.00. Taxpayer assumed a twelve percent yield as part of its present value calculation. As a result, Taxpayer concluded the improved real property would have a value of \$6,050,000.00 minus the \$3,299,574.00 lease value or \$2,750,426.00 with a tax due to the Town of \$14,510.00.

The Town argued that the Code requires the tax to be calculated on the documents related to the sale. The Town asserted that to do otherwise would create an administrative nightmare to attempt to determine what would be the true substance of each transaction. As a result, the Town argued the tax must be based on the form of the transaction. The Town assessed penalties for failure to file and for failure to timely pay taxes. The original penalties assessed by the Town were in the amount of \$25,802.71. Subsequently, the Town determined that Taxpayer had filed a report for rental tax for the month of November 2008. As a result, the Town reduced the penalties to an amount of \$5,160.54. The Town acknowledged the penalties could be abated if Taxpayer demonstrated reasonable cause.

First, there was no dispute that there was a speculative builder sale by Taxpayer in November 2008. As a result, the sales price of the "improved real property" would be taxable pursuant to Sections 100 and 416. In some instances, the value of a lease would not be part of the "value of the improved real property". In this case, because of the length of the lease, 75 years, we conclude the lease value is encompassed in the "value of the improved real property". This conclusion is consistent with Subsection 416(a)(3) which defines "sale of improved property" to include any form of transaction, whether characterized as a lease or otherwise, which in substance is a transfer of title of, or equitable ownership in, improved real property and includes any lease of the property for a term of thirty (30) years or more. We also conclude that Taxpayer's present value calculation does not result in a reasonable result. Taxpayer had purchased the vacant land for \$2,250,000.00 and made improvements in the amount of \$2,210,000.00 or a total cost of \$4,460,000.00. If we include administrative costs, the total costs for the land and improvements would be approximately \$5,000,000.00. Taxpayer has proposed the value of the improved real property to be only about half of that amount of \$2,750,000.00. We conclude a reasonably prudent business person would not buy land and have improvements constructed and immediately sell the improved property at a discount of almost fifty percent. Based on all the above, we must deny Taxpayer's request to reduce the selling price of improved real property from the amount of \$6,050,000.00.

Lastly, we have the matter of penalties. The City assessed Taxpayer for penalties pursuant to City Code Section 5-10-540 (“Section 540”) for failure to file, and failure to timely pay. Subsequently, the Town concluded the penalties for failure to file were not proper and removed them from the assessment. The penalties for failure to timely pay may be waived for “reasonable cause”. Reasonable cause is defined in Section 540 that a taxpayer exercised ordinary business care and prudence, i.e., had a reasonable basis for believing that the tax did not apply to the business activity. Prior to this sale, Taxpayer’s sales have not fallen within the scope of the speculative builder classification. As a result, we conclude that it was reasonable for Taxpayer to believe this sale would also not be classified as a speculative builder sale. As a result, we conclude that Taxpayer has provided reasonable cause to have the penalties waived. Based on all the above, we conclude that Taxpayer’s protest should be partly granted and partly denied, consistent with the Discussion, Findings, and Conclusions, herein.

FINDINGS OF FACT

1. On October 27, 2009, Taxpayer filed a protest of a tax assessment made by the Town.
2. On September 10, 2009, the Town issued an audit assessment of Taxpayer.
3. The assessment was for the period of November 2008.
4. The assessment was for taxes in the amount of \$103,210.82, interest up through September 2009 in the amount of \$3,870.38, and penalties totaling \$25,802.71.
5. Subsequently, the Town determined that Taxpayer had filed a report for rental taxes for November 2008.
6. The Town reduced the penalty amount to \$5,160.54.
7. Taxpayer had built a drugstore on the *Undisclosed Location* for *Quick Trip Store*.
8. Prior to commencing construction on the improvements, Taxpayer had entered into a 75 year lease with *Quick Trip Store* at the rate of \$33,000.00 per month.
9. Taxpayer sold the improved *Undisclosed Location* Property on November 9, 2008 for \$6,050,000.00 to the *New Buyers*.

10. As part of the sale agreement to the *New Buyer's*, Taxpayer had to transfer all rights, title and interest in the *Quick Trip Store* lease.
11. Taxpayers computed a present value for the *Quick Trip Store's* lease to be \$3,299,574.00 based on a twelve percent yield.
12. Taxpayer had purchased the vacant land at *Undisclosed Location* for \$2,250,000.00.
13. Taxpayer had improvements made on the *Undisclosed Location* Property in the amount of \$2,210,000.00.
14. Prior to the sale of the *Undisclosed Location* Property, Taxpayer's sales had not fallen within the scope of the speculative builder classification.

CONCLUSIONS OF LAW

1. Pursuant to ARS Section 42-6056, the Municipal Tax Hearing Officer is to hear all reviews of petitions for hearing or redetermination under the Model City Tax Code.
2. There was no dispute that Taxpayer's sale of the *Undisclosed Location* Property was a taxable speculative builder sale pursuant to Sections 100 and 416.
3. Subsection 416(a)(3) defines "sale of improved property" to include any form of transaction, whether characterized as a lease or otherwise, which in substance is a transfer of title of, or equitable ownership in, improved real property and includes any lease of the property for a term of thirty (30) years or more.
4. The *Quick Trip Store's* lease was part of the "sale of improved real property" pursuant to Subsection 416(a)(3).
5. Taxpayer's request to reduce the selling price of improved real property from the amount of \$6,050,000.00 should be denied.
6. The Town was authorized pursuant to Section 540 to assess penalties for failure to timely pay taxes.
7. Taxpayer demonstrated reasonable cause to have the penalties waived for failing

- to timely pay taxes.
8. Taxpayer's October 27, 2009 protest should be partly granted and partly denied, consistent with the Discussion, Findings, and Conclusions, herein.
 9. The parties have timely appeal rights pursuant to Model City Tax Code Section 575.

ORDER

It is therefore ordered that the October 27, 2009 protest by *Taxpayer* of a tax assessment made by the Town of Queen Creek should be partly granted and partly denied consistent with the Discussion, Findings, and Conclusions, herein.

It is further ordered that the Town of Queen Creek shall remove all penalties assessed in this matter.

It is further ordered that this Decision is effective immediately.

Municipal Tax Hearing Officer